



THE ASSISTANT SECRETARY OF THE NAVY

Research Development and Acquisition

1000 Navy Pentagon

Washington DC 20350-1000

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MEMORANDUM FOR DISTRIBUTION

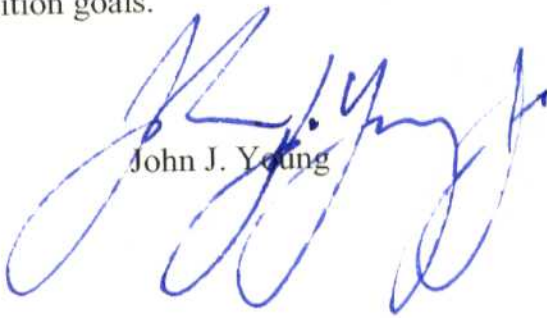
Subj: CONTRACT INCENTIVE STRATEGIES

Ref: (a) ASN(RDA) memo dtd Oct 28, 2003, Subj: Contract Incentives, Profits and Fees
(b) ASN(RDA) memo dtd Dec 23, 2004, Subj: Contract Profit and Incentive Arrangements

In references (a) and (b), I provided guidance on establishing contract profit and incentive arrangements. I continue to believe the combination of appropriate levels of potential profit and carefully constructed incentive arrangements provides one of the most effective tools we have for influencing contractor performance and managing risks.

While progress has been made in this area, it is important to keep in mind that the key to effective profit and incentive arrangements is to ensure the contractor is well rewarded for outstanding performance, is adequately rewarded for good performance, and is either not rewarded at all or is penalized for substandard performance. In creating profit and incentive arrangements, then, it is critical that the government team defines what performance is minimally required and what performance is the maximum for which the government would be willing to pay a higher amount. This range represents the scope of possible performance outcomes to which our incentives should apply. In particular, an incentive provision that allows the contractor to continue to earn profit when performance falls below the government's minimum requirements is unacceptable and should not be used. In fact, at that point it would be appropriate to consider terminating the contract or begin applying some form of disincentives. Similarly, we should not structure contracts that pay additional incentives for increased performance that either provides no real additional benefit or causes our overall costs to exceed the amount that the Department is willing to pay for the product or service we are acquiring.

Your continued focus on contract profit and incentive arrangements is essential. These arrangements are vitally important to our success -- we need to ensure they are crafted thoughtfully and with a clear understanding of how they will work to support the Department's overarching acquisition goals.


John J. Young

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